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SENSITIVE

SIPDIS

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TAGS: EFIN ECON ECIN RP CN XE XD
SUBJECT: Philippines: Keeping Afloat in Choppy Waters

REFS: A) Manila 0378, B) 08 Manila 0680, C) 08 Manila 2740

SENSITIVE BUT UNCLASSIFIED

¶1. (SBU) Summary: The Philippines is suffering from increasing economic pain, but continues to weather the global downturn better than most of its neighbors. The government has responded to the crisis mainly through monetary easing and measured fiscal expansion. There has been limited protectionist pressure thus far. However, in the run-up to 2010 presidential elections, there is little hope for much needed reforms to further liberalize the economy. End Summary.

## Trade Slump Deepens

¶2. (U) Merchandise exports collapsed 41% year-on-year to January 2009, the sharpest drop on record. Electronics exports, which contribute more than 60% of the Philippines' annual export revenue, dropped 48.4%. Imports declined by 34.5%. Excluding oil/fuel (where prices drive the figures), January 2009 imports still fell by over 28% from January 2008. Imports of raw/intermediate materials contracted by 27.4%, while inputs for the electronics industry sliding by 40% year-on-year. January imports of capital equipment and consumer goods declined by 33.1% and 9.5%, respectively, from year-ago levels.

¶3. (SBU) Government officials told us they may need to reduce their projection of a $700 million balance of payments surplus. The Central Bank's international reserves stood at $38.9 billion as of end-March 2009, up from $36.7 billion at the end of September 2008 and equivalent to about six months worth of imports and nearly three months of foreign debt obligations maturing over the next twelve months.

## Workers' Remittances Shaky

¶4. (U) January 2009 overseas workers' remittances barely expanded (0.1%) from January 2008 -- the slowest year-on-year expansion recorded since mid-2003. In a recent forum sponsored by the Philippine Central Bank, World Bank economists projected a 4% decline in overseas Filipino remittances in 2009 due to the slowing global economy. Returning workers, softer wages, and political pressure in some countries to give jobs to their respective nationals all pose challenges.

¶5. (U) About 6,400 of the 4 to 5 million overseas Filipino workers have lost their jobs (mostly from Taiwan and the United Arab Emirates), while project cancellations and reduced production prevented the departure of some 365 workers slated to leave for

overseas. However, a 27% year-on-year increase in contracting of Filipino workers for overseas employment in January and February provides some reason for optimism. Between 2002 and 2009 remittances expanded annually by an average of nearly 16% to equal more than 10% of Philippine Gross Domestic Product. Even slow growth in remittances this year would be an important brake on broader economic growth.

Employment Up; As Is Unemployment
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¶6. (U) Employment continued to grow in 2008, but was not able to keep up with the increasing number of workers. Unemployment hit 7.7% in January, according to the Government's quarterly Labor Force Survey, up from 7.4% in January 2008. At 745,000, new entrants to the labor force outpaced net job creation of 565,000. The share of employees working less than the regular 40-hour work week also increased from 35.2% to 36.3%.

¶7. (U) The Labor Department estimates that about 50,400 local workers have been laid off and 59,150 put on flexible work schedules since October 2008. The electronics industry has been hard hit, accounting for nearly half of workers affected, with the rest mainly from the garments, automotive, mining, real estate and business services, and metal and woodworking industries. Business process outsourcing has taken up some of the slack, and expects to generate more than 100,000 new jobs in 2009.

Auto Sector and Real Estate: Down, But Not Out
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¶8. (U) Automobile manufacturers report that vehicles sold totaled



28,564 units during the first quarter of 2009, down only 1% year-on-year. Major real estate developers described the impact of the global crisis on their business as "challenging but not catastrophic." Residential property sales have been most affected, partly because of current uncertainties surrounding overseas Filipino employment and remittances. Growth of office rentals has slowed significantly from recent years, but still cushioned by continuing demand from business process outsourcing.

Banking Sector Credit and NPL Ratios Holding So Far
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¶9. (U) Banks and borrowers report stricter due diligence and more stringent and selective lending policies for non-prime accounts but not a credit/liquidity crunch. Latest Central Bank statistics as of February 2009 showed outstanding commercial bank loans up more than 22% year-on-year. The non-performing loan ratio of commercial banks hit a low of 3.5% in December, the lowest it has been since the Asian financial crisis. However, the ratio inched up again during the first two months of 2009, to 3.8% in February, and the Central Bank expects it to rise, perhaps to as high as 6% this year.

Further Monetary Easing
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¶10. (U) The Philippine Monetary Board cut Central Bank borrowing and lending rates by 25 basis points during its March 5 meeting -- the third reduction (now totaling 125 basis points) since December
¶2008. In announcing the decision, the Monetary Board noted that upside risks from volatile oil prices and exchange rate pressures call for a carefully calibrated monetary policy.

Stimulus and Fiscal Tightrope
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¶11. (SBU) As we reported Ref B, the Government has opted for a larger deficit in 2009 equivalent to 2.2% of Gross Domestic Product, as a fiscal stimulus. Preliminary data for January-February 2009 showed non-debt expenditures on track. However, officials tell us that revenue strains are emerging, with tax collections short of the two-month government goal by about 5%. Increased non-tax revenues helped keep the two-month deficit (67 billion pesos) within the 68.2

billion peso ceiling.

¶12. (SBU) According to Finance Secretary Margarito Teves, economic managers are reviewing macroeconomic assumptions. We expect downward revisions to import forecasts and the (overly optimistic) 3.7%-4.4% GDP growth target. Teves hinted that the review would result in downward adjustments to revenue goals; and, consequently, to the programmed deficit ceiling. Although the government wants to spend more to help prop up the economy, economic managers are concerned that a significantly larger deficit could cast doubts over the Philippines's commitment to fiscal stability and unsettle credit rating agencies and debt markets.

Other Responses
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¶13. (U) The government's Board of Investment recently announced relaxation of export performance requirements for export establishments registered for government incentives. Some business and agricultural groups have called for the deferment of tariff reductions under the ASEAN Free Trade Area-Common Effective Preferential Tariff agreement due to take effect in January 2010. Trade Department officials told us that ASEAN currently is not considering delaying trade liberalization commitments and that they were not inclined to support such a step.

Comment
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¶14. (SBU) We adjudge the Philippine policy response to the increasing economic pain to be measured and appropriate. However, with the political class already focused on the 2010 presidential and congressional elections, there remains some risk of pressure building for populist policies. In any case, there is scant prospect for any of the reforms needed to open up the economy, expand the revenue base, boost competitiveness, and address constraints to sustainable growth sufficient to reduce poverty (Ref C).

Kenney